

# **Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on Amathole District Municipality**

## **Report on the audit of the consolidated and separate financial statements**

### **Qualified opinion**

1. I have audited the consolidated and separate financial statements of the Amathole District Municipality and its subsidiary (the group) set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2017, the consolidated and separate statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the consolidated and separate financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the effect of the matters described in the basis for qualified opinion section of my report, the consolidated and separate financial statements present fairly, in all material respects, the consolidated and separate financial position of the group as at 30 June 2017, and their financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognized Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2016 (Act No. 3 of 2016) (DoRA).

### **Basis for qualified opinion**

#### **Property, plant and equipment**

3. The municipality did not recognise all items of property, plant and equipment in accordance with GRAP 17, *Property, plant and equipment*. Not all infrastructure assets were recorded in the fixed asset register and the useful lives of infrastructure assets were not assessed for any indications that the group's expectation about the useful lives have changed since the preceding reporting date. Due to the lack of systems, it was impracticable to determine the full extent of the understatement of infrastructure assets. Consequently, I was unable to determine whether any adjustments were necessary to the net carrying amount of infrastructure assets of R4,5 billion, as disclosed in note 4 to the consolidated and separate financial statements.
4. In addition, the group did not recognise all items of property, plant and equipment in accordance with GRAP 17, *Property, plant and equipment*, as the following deficiencies were identified:
  - Assets under construction were incorrectly recognised as transfers and grants expenditure
  - Assets under construction were not recorded at appropriate amounts
  - Research costs were incorrectly capitalised into assets under construction
  - The fixed asset register did not agree with the financial statements

As a result, infrastructure assets disclosed in note 4 to the consolidated and separate financial statements were understated by R192,1 million, transfers and grants expenditure as disclosed in note 30 to the consolidated and separate financial statements was overstated by R167,4 million, depreciation and amortisation as disclosed in note 34 to the consolidated and separate financial statements was overstated by R16,6 million and accumulated surplus was understated by R8,1 million.

### **Commitments**

5. The group did not disclose all contractual commitments for acquisition of property, plant and equipment in accordance with GRAP 17, *Property, plant and equipment*. Recorded amounts did not agree with invoices inspected, invalid contracts were incorrectly included in the commitments register and not all commitments were recorded in the commitments register. This resulted in overstatement of commitments, as disclosed in note 43 to the consolidated and separate financial statements, by R67,6 million.

### **Context for the opinion**

6. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the consolidated and separate financial statements section of my report.
7. I am independent of the group in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) together with the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
8. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

### **Emphasis of matters**

9. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Material impairments**

10. As disclosed in note 12 to the consolidated and separate financial statements, cumulative debt impairment totalling R619,2 million (2016: R527,4 million) were incurred as a result of allowances for impairment relating to receivables from exchange transaction.

### **Restatements of corresponding figures**

11. As disclosed in note 46 to the consolidated and separate financial statements, the corresponding figures for 30 June 2016 have been restated as a result of errors in the consolidated and separate financial statements of the group at, and for the year ended, 30 June 2017.

### **Unauthorised expenditure**

12. As disclosed in note 48 to the consolidated and separate financial statements, unauthorised expenditure to the cumulative amount of R67,4 million was incurred over the years due to overspending of the operational budget at vote level.

### **Fruitless and wasteful expenditure**

13. As disclosed in note 49 to the consolidated and separate financial statements, fruitless and wasteful expenditure to the cumulative amount of R2,6 million was incurred over the years due to interest and penalties charged on late payments made by the group.

### **Irregular expenditure**

14. As disclosed in note 50 to the consolidated and separate financial statements, irregular expenditure to the cumulative amount of R21,6 million was incurred over the years as a result of non-compliance with supply chain management laws and regulations.

### **Financial sustainability**

15. As disclosed in note 59 to the consolidated and separate financial statements, the group is facing a number of financial risks that cast doubt on its ability to sustain its current level of operations in the near future. The key financial risks identified include:

- an inability to pay creditors within due dates
- inability to collect revenue billed
- net current liability position.

In addition, the actions taken by management to mitigate the impact of these risks are disclosed in this note.

### **Other matters**

16. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Unaudited disclosure note**

17. In terms of section 125(2)(e) of the MFMA, the group is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the consolidated and separate financial statements and, accordingly, I do not express an opinion thereon.

### **Unaudited supplementary schedules**

18. The supplementary information set out on pages xxx to xxx does not form part of the consolidated and separate financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

### **Responsibilities of the accounting officer**

19. The accounting officer is responsible for the preparation and fair presentation of the consolidated and separate financial statements in accordance with SA Standards of

GRAP and the requirements of the MFMA and DoRA, and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

20. In preparing the consolidated and separate financial statements, the accounting officer is responsible for assessing the group's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the accounting officer either intends to liquidate the group or to cease operations, or has no realistic alternative but to do so.

### **Auditor-general's responsibilities for the audit of the consolidated and separate financial statements**

21. My objectives are to obtain reasonable assurance about whether the consolidated and separate financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated and separate financial statements.
22. A further description of my responsibilities for the audit of the consolidated and separate financial statements is included in the annexure to the auditor's report.

### **Report on the audit of the annual performance report**

#### **Introduction and scope**

23. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
24. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
25. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2017:

<b>Development priorities</b>	<b>Pages in the annual performance report</b>
KPA 2: Basic service delivery and infrastructure investment	x – x
KPA 3: Local economic development	x – x

26. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

27. I did not identify any material findings on the usefulness or reliability of KPA3 – local economic development. The material finding in respect of the usefulness KPA 2 – basic service delivery and infrastructure investments is as follows:

#### **KPA 2 – Basic service delivery and infrastructure investment**

28. There was no clear and logical link between the target and the indicator to which it relates, as required by the Framework for managing programme performance information (FMPPI). The target focused on operation and maintenance of a solid waste site, while the indicator aimed to achieve construction of a solid waste site.

#### **Other matters**

29. I draw attention to the matters below.

#### **Achievement of planned targets**

30. Refer to the annual performance report on pages x to x and x to x for information on the achievement of planned targets for the year and explanations provided for the under-achievement of a number of targets. This information should be considered in the context of the material findings on the usefulness of the reported performance information in paragraph 28 of this report.

#### **Adjustment of material misstatements**

31. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of basic service delivery and infrastructure investment. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness of the reported performance information. Those that were not corrected are reported above.

#### **Report on audit of compliance with legislation**

#### **Introduction and scope**

32. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with

specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

33. The material findings on compliance with specific matters in key legislations are as follows:

#### **Expenditure management**

34. Money owed by the municipality was not always paid within 30 days as required by section 65(2)(e) of the MFMA.
35. Effective steps were not taken to prevent fruitless and wasteful expenditure amounting to R2,2 million, as disclosed in note 49 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful was caused by interest and penalties on late payments.
36. Effective steps were not taken to prevent irregular expenditure amounting to R16,1 million as disclosed in note 50 to the annual financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by deviations from the competitive bidding process without justifiable reasons.

#### **Annual financial statements**

37. The consolidated and separate financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of receivables from exchange transactions and VAT payable identified by the auditors in the submitted consolidated and separate financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the consolidated and separate financial statements receiving a qualified audit opinion.

#### **Procurement and contract management**

38. Some of the goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).

#### **Consequence management**

39. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.
40. Irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.
41. Some of the losses resulting from irregular expenditure were certified by the council as irrecoverable without having conducted an investigation to determine the recoverability of the expenditure, in contravention of section 32(2)(b) of the MFMA.

## **Budget management**

42. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R59,9 million, as disclosed in note 48 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed unauthorised expenditure was caused by lack of credible and complete financial information due to challenges with migration of financial data from the old to the new financial system and challenges with processing of transactions.

## **Asset management**

43. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

## **Other information**

44. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report the audit committee's report. The other information does not include the consolidated and separate financial statements, the auditor's report thereon and those selected development priorities presented in the annual performance report that have been specifically reported on in the auditor's report.
45. My opinion on the consolidated and separate financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
46. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated and separate financial statements and the selected development priorities presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
47. If, based on the work I have performed, I conclude that there is a material misstatement of this other information; I am required to report that fact. I have nothing to report in this regard.

## **Internal control deficiencies**

48. I considered internal control relevant to my audit of the consolidated and separate financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, and the findings on compliance with legislation included in this report.
49. Management did not exercise adequate oversight over financial reporting, reporting on predetermined objectives and compliance. As a result, the consolidated and separate financial statements and annual performance report contained material misstatements due to lack of regular processing and reconciliation of transactions and non-compliance with legislation was not adequately monitored.

## Other reports

50. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the group's consolidated and separate financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the consolidated and separate financial statements or my findings on the reported performance information or compliance with legislation.
51. At the time of this report, the Office of the Public Protector was conducting an external investigation into alleged procurement irregularities. The investigation was in progress and the expected date of the outcome was unknown.
52. At the time of this report, an external service provider was conducting an investigation of procurement processes, staff appointment processes and debit orders for the past three financial years. The investigation was in progress and the expected date of the outcome was 31 July 2018.
53. An external investigation into alleged procurement irregularities was conducted by an external service provider as commissioned by the National Treasury. The investigation has been completed and a report tabled in the council.

AUDITOR GENERAL

East London

12 December 2017



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## **Annexure – Auditor-general’s responsibility for the audit**

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the consolidated and separate financial statements, and the procedures performed on reported performance information for selected development priorities and on the municipality's compliance with respect to the selected subject matters.

### **Financial statements**

2. In addition to my responsibility for the audit of the consolidated and separate financial statements as described in the auditor's report, I also:
  - identify and assess the risks of material misstatement of the consolidated and separate financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
  - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the group's internal control.
  - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer.
  - conclude on the appropriateness of the accounting officer's use of the going concern basis of accounting in the preparation of the consolidated and separate financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the group's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the consolidated and separate financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the consolidated and separate financial statements. My conclusions are based on the information available to me at the date of the auditor's report. However, future events or conditions may cause the group to cease to continue as a going concern.
  - evaluate the overall presentation, structure and content of the consolidated and separate financial statements, including the disclosures, and whether the consolidated and separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
  - obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express an opinion on the consolidated and separate financial statements. I am responsible for the direction, supervision and performance of the group audit. I remain solely responsible for my audit opinion.

### **Communication with those charged with governance**

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and here applicable, related safeguards.